



DEAN ANDAL  
Chairman, Board of Equalization

## California Business Update

### A Uniform Jurisdictional Standard (The "Nexus Proposal")

*The Solution to Bring Certainty  
to E-Commerce Taxation*

The growth of the Internet has engendered an explosion in interstate commerce. This burgeoning trend has meant an increase in the number of businesses that fall victim to tax traps inherent in conducting business in multiple states.

The Uniform Jurisdictional Standard takes a pragmatic approach and clearly defines when a business is legally obligated to collect a state's sales tax. It also clarifies a related problem by outlining exactly when business activity triggers nexus for taxes imposed on and measured by income or receipts.

In its 1992 *Quill* decision, the United States Supreme Court made it clear that it is Congress' place to act in this area of taxation. The nexus proposal essentially picks up where the Supreme Court left off by codifying the *Quill* decision. It appropriately limits tax obligations to those incurred when a person establishes a "substantial physical presence" within a taxing jurisdiction. The proposal applies the Supreme Court standard and ensures the Internet will continue as an engine of economic growth – benefiting everyone: taxpayers and taxing authorities alike.

Instead of an outright ban on certain forms of taxation, this solution provides

See *NEXUS*, Page 3

### Appeals Time Significantly Reduced

One of the complaints Board of Equalization (BOE) members often hear from taxpayers is the amount of time it takes to resolve appeals with the BOE.

In 1998, BOE staff was directed to look at the entire appeals process and determine ways to shorten the duration of an appeal. Staff subsequently came back with a report outlining stages in the process where time could be reduced and duties of various departments could be streamlined. This plan was immediately implemented.

In 1999, the focus turned to district offices and priority was given to cases that were more than two years old. The goal

was to clear out "old" cases.

In District Two, after much hard work, offices have managed to clear out all but a few cases older than two years.

Time is valuable to everyone. Audits and appeals are inconvenient and costly. When an audit is conducted and there is disagreement over the amount of tax liability, it is to the benefit of both parties to reach a conclusion as soon as possible without sacrificing fairness. In the past, the length of time to resolve an appeal was longer than necessary in some cases due to BOE actions.

See *APPEALS*, Page 3

### TAX BIT

#### Board moves its Offer-in-Compromise Program to Taxpayer Rights Advocate's Office.

The new and improved program and the Board's policy on offers-in-compromise will soon be widely publicized in the hopes of attracting greater participation in the program. Tax debtors need to realize they have another option at hand – they don't merely have to accept onerous payment plans and face the possibility of being subject to collection action. For more information, contact the Taxpayer Rights Advocate at (916) 324-2798.

#### Audit Assessments of Cellular Phone Companies Canceled.

At a recent Board hearing, four taxpayers' liabilities were reduced by a combined total of almost \$700,000 in light of the Office of Administrative Law's approval of last year's Regulation 1585 (Cellular Telephones, Pagers, and Other Wireless Telecommunication Devices). This Regulation clarifies the appropriate application of tax to cellular telephone sales.

#### Refunds of Charter Bus Companies' Liabilities Approved.

The Board also canceled over \$325,000 assessed against two operators of bus charter services. These actions are the direct result of a 1999 Board decision dealing with the tax-exempt status of buses used in interstate transportation.

See *BITES*, Page 2

## Proposed Annotations Regulation

As early as 1996, concerns were raised about annotations, which are summaries of the conclusions reached in selected legal rulings of counsel, being used incorrectly by staff auditors and attorneys. Some staff attorneys were relying on annotations for their positions just as they would on regulations or statutes. Complaints were raised that some BOE auditors were mistakenly telling taxpayers that certain annotations, by themselves, determined the taxpayers' tax liabilities. Both BOE staff and the public needed to be made aware that annotations by themselves were simply guidance – not binding authority – because they did not have the force or effect of law.

In 1997, the process of reforming BOE's annotations began. In a use tax case involving Yamaha Corporation of America, a question in dispute was the deference to be given a BOE sales and use tax annotation. The case went to the California Supreme Court. An *amicus* brief was filed in support of Yamaha's position and asked the Court to reverse the lower court's use of an elevated standard of review when considering annotations.

In a published opinion, Yamaha Corporation v. State Board of Equalization, 19 Cal.4<sup>th</sup> 1 (1998), the California Supreme Court agreed with Yamaha that the Court of Appeal applied the wrong standard of review when it held that the

interpretations of statutory law in BOE annotations are entitled to deference by the court unless established by the taxpayer to be arbitrary, capricious or without rational basis. The California Supreme Court instead concluded that the deference due an agency interpretation "will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control."

After the Yamaha opinion, annotations without supporting legal rulings of counsel were discarded, as were those with illegible supporting documents. The next step was to ensure that future annotations are published and used according to certain guidelines.

In 1999, the Board adopted proposed Regulation 5200 "Annotations" to state what constitutes a legal ruling of counsel, proper use of annotations, and the publication process. A complete copy of this proposed regulation can be obtained from the BOE's website at [www.boe.ca.gov](http://www.boe.ca.gov).

Regulation 5200 was submitted to the Office of Administrative Law (OAL) late last year. Once the regulation is final, the Board will better serve the public by ensuring that future annotations are only published and applied according to standards that are available to the general public.

system included non-taxable intangible assets, such as permits, licenses and goodwill and used a rent/royalty method to come up with their own opinion of value. A county appraiser disagreed and included the intangibles in his appraisal using a sales price and income method of valuation. The Assessment Appeals Board ultimately sided with the taxpayer – a decision that will save nearly \$1 million annually in property taxes that should never have been assessed in the first place.

## Term Limits for County Assessors?

The imposition of term limits on county property tax assessors has been a recent topic of discussion in and around Sacramento. A Constitutional Amendment to specifically provide that an assessor shall be elected for four-year terms and may serve no more than two terms will be introduced in the State Legislature this month.

In the last decade, many elected offices throughout California have become subject to term limits. Whether through local initiative or the statewide adoption of Proposition 140, term limits have been overwhelmingly approved by the voters.

Why not provide a similar limitation on elected county property tax assessors? They, like other elected officials, are politicians and face re-election every four years. And they, like other elected officials are policymakers. BUT, they – *unlike* many elected officials – are not well known. As such, incumbent county assessors rarely face competition and are merely re-elected without much debate.

Term limits create more competitive races by encouraging newcomers to run for the office. A greater turnover in these offices could lead to new ideas and change: a very desirable goal. Finally, term limits have proven to foster an increase in the number of women and minorities elected to many offices: the county assessors offices could use such representation.

Look for this Constitutional Amendment to ensure that important property taxation issues are addressed by elected officials who are accessible and responsive to their constituents.

## BITES

■ Continued from Page 1

### Assessment Appeals Board Sides with Taxpayer on Property Value.

In a recent dispute, the Assessment Appeals Board in San Diego agreed with arguments put forth by Allied Waste Industries and rejected the county government's method of valuing property. Allied Waste maintained that their purchase price for a waste

## NEXUS

■ *Continued from Page 1*

a constitutional framework for approaching taxable activities. It is clear, simple and fair.

States, localities and private enterprises have spent too many years in court wrangling over issues of nexus. These cases unnecessarily clog the court system and are time consuming and costly for all parties involved. The nexus proposal curbs the need for litigation by clearly spelling out what circumstances make a business fall under the requirement to collect sales taxes or make it subject to a state's income-based tax.

Rather than legislating from scratch, the proposal builds on long-standing federal law, known as Public Law 86-272, which lays out parameters for when states can legitimately tax businesses whose only connection to a state is soliciting orders for the sale of tangible goods.

The federal Advisory Commission on Electronic Commerce (ACEC) is looking at many issues, but most acknowledge the nexus issue is the most important and immediate problem that needs to be addressed.

A copy of the Uniform Jurisdictional Standard is available on the web at: <http://www.boe.ca.gov.members>.

## APPEALS

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Now that the Appeals Section and the District Two offices have implemented new policies, the amount of time a case takes from beginning to end should be less than two years if the taxpayer is cooperative and the case is not an extraordinarily complicated one.

The next step is to implement these policies statewide to ensure there are no more five-year appeals – a goal worthy of some extra effort and attention.

## Applying Substantial Physical Presence Standard to E-Commerce

*Elements of the nexus proposal:*

- Creation of a uniform national jurisdictional standard for taxing electronic commerce, based on the “substantial physical presence” test. This is the test the United States Supreme Court has established as the key to applying the Commerce Clause provision of the U.S. Constitution.
- Federal legislation to build on existing law known as Public Law 86-272 (15 USC Section 381-84) and apply nexus both as it relates to the obligation of a business to collect sales taxes and to when an entity is subject to a business activity tax.
- Definition of which business activities constitute “substantial physical presence” and those that do not. The following activities **DO NOT** constitute physical presence for establishing nexus under the Uniform Jurisdictional Standard:
  - ▶ solicitation of orders or contracts for tangible or intangible property or services that are approved outside a state and are fulfilled from a point outside a state;
  - ▶ presence or use of intangible property in a state, such as patents, copyrights, trademarks, logos, securities contracts, money, deposits, electronic or digital signals and web pages;
  - ▶ use of the Internet to maintain a website accessible by customers in a state;
  - ▶ use of an Internet Service Provider (ISP), On-line Service Provider, or other types of Internet access providers, or World Wide Web hosting services to maintain, take or process orders via a web page site or server located in a state;
  - ▶ use of any service producer for transmission of communications by cable, satellite, radio, telecommunications or similar systems;
  - ▶ affiliation with a person located in a state, unless the person is an “agent” of the business entity who meets the substantial physical presence standard;
  - ▶ use of independent contractors or representatives for warranty or repair services.

**Visitors Welcome at**  
**[www.boe.ca.gov](http://www.boe.ca.gov)**

## The Case for an Elected Tax Commission

California has a unique system for tax administration that consists of three separate state agencies, including an elected Board. Most other states have a single tax agency that reports directly to the governor.

The Board of Equalization (BOE) administers the sales and use tax and about 30 special tax programs. The BOE is comprised of four members elected directly, by district, to the BOE and the California State Controller, elected at large, serving as the Board's fifth member.

The Franchise Tax Board (FTB) administers the state personal income tax and the corporate income and franchise tax. The FTB is comprised of three members—the Chair of the BOE, the California State Controller, and the Director of the Department of Finance, who is appointed by the Governor.

The Employment Development Department (EDD) administers employment and payroll taxes. An appointed Director, who ultimately reports to the Governor, heads the EDD.

While these three agencies have administrative responsibility for different tax programs, the fact remains that they each administer tax programs and each has its own costly bureaucratic structure. Taxpayers are often confused about which agency handles a tax problem or where to file their returns.

Combining all tax programs into a single agency would result in significant monetary savings from the consolidation of functions currently performed by three bureaucracies, would eliminate the confusion regarding which agency handles what tax, and would provide taxpayers with centralized services.

The Legislature has made many attempts to consolidate the agencies into a single Department of Revenue or Tax Commission. A recent attempt to consolidate tax administration into the BOE was vetoed by Governor Wilson, who apparently objected to his loss of control that would have resulted. Conversely, proposals to consolidate tax administration into a single agency controlled by the Governor have also failed.

The BOE is an elected Board whose members are accountable and responsive to voters. Appointed bureaucrats, such as the Internal Revenue Service Commissioner or other states' Department of Revenue Directors are not accountable to voters. Elected members are easily accessible to the taxpayers they represent. Appointed bureaucrats working in an ivory tower are not available to most taxpayers. In polls, voters overwhelmingly approve of representation by elected tax administrators rather than appointed bureaucrats.

BOE members are also subject to term limits. Bureaucrats serve for an indeterminate term that can continue from one administration to another. Term limits encourage new ideas, change, and improvement. Open-ended appointments create atrophy in a bureaucracy.

California should move into the 21<sup>st</sup> century with a more business-like approach to government. A first step would be to consolidate all tax administration functions into a single agency directed by an elected Board subject to term limits.



### COMMENTS?

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